

## Ruling on rights of non-registered investors to enforce shareholder rights

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In the Matter of Lancelot Investors Fund, Ltd (in Official Liquidation) (unreported 27 April 2015), the Cayman Islands Court of Appeal (CA) considered whether a beneficial owner of shares in a fund could seek to prove in the liquidation of that fund in respect of rights granted under a side letter, where the rights attached to shares which were held through a custodian.

At first instance the Grand Court decided that the proof of debt was not admissible as:

(i) only the registered (rather than beneficial) owner of shares can enforce rights relating to those shares; and (ii) on the facts of this case the investment manager (IM) who had entered into the side letter, lacked sufficient authority to bind the fund.

As is common in the Cayman Islands, the shares in question were held by a custodian. The beneficial owner of the shares (BO) had entered into a side letter which sought to reduce the lock up period, which, the BO claimed, gave it the right to enforce the custodian's redemption from the fund by way of a proof of debt.

In its ruling, which upheld the dismissal of the proof of debt, the CA confirmed the general rule that only a registered shareholder may bring proceedings to vindicate shareholder rights, but found that in this case, the beneficial owner (BO) of shares had attained the status of creditor by reason of being an equitable assignee of the claims of the registered shareholder / custodian. However, the CA agreed with the Grand Court in finding that the IM lacked authority to enter into the side letter on behalf of the fund, and therefore the side letter (and consequently the proof of debt) was unenforceable.

The CA confirmed that only the registered shareholder could make a valid redemption request. A

Cayman fund's Articles will typically provide that it has no obligation to recognise a trust of shares. In any event, in this case it was the custodian who had made the redemption request. However, upon liquidation, all claims against the fund, including the claim to redemption proceeds, became provable in the winding up, and were freely assignable under the Companies Winding Up Rules. There is no requirement for an assignee to be a shareholder or have any status in relation to the fund other than as assignee of the assigned claim. The CA held that the BO became an equitable assignee of the redemption proceeds claimed by the proof of debt by reason of the terms of the custodian agreement. The BO was therefore considered to be a creditor and could appeal the decision of the Grand Court.

In relation to the issue of the authority of the IM to enter into a binding side letter on behalf of the fund- the CA's ruling was that the IM lacked both actual and ostensible authority to bind the fund. The IM accepted that the documents did not support it having actual authority to bind the fund but its case was that it had ostensible or apparent authority to do so and relied upon an assertion in the fund's information memorandum that the IM would be "responsible for and control all the day to day operations of the Fund, including its investment activities and decisions".

The CA decided that this statement was insufficient to establish the IM's ostensible authority to "cover something as fundamental as changes to the basis on which the Company's capital could be withdrawn by the redemption of shares", but rather provided for the IM's ostensible authority in relation to the day to day activities of the Fund in relation to its investments. The CA considered that an IM would not generally be regarded by the world at large to have authority to transmit decisions of the fund's board of directors and therefore any representations made by the IM as to the Fund's decisions about share redemptions could not be relied on.

## **Comment**

A few points to be drawn from the decision:

- It remains the case that registered shareholders are the only ones who may enforce rights attaching to their shares.
- Any creditor rights which have crystallised at the date of liquidation are freely assignable to a third party, and an assignee may enforce those rights directly against the fund. There is no requirement that the assignee be a shareholder or have any other relationship with the fund.
- An equitable assignment may arise by reason of the custodian relationship- and this will be a matter of analysis of the specific terms of the applicable custodian agreement.
- It remains the case that in order for a side letter to be effective it must be entered into on both sides by individuals with authority to bind the respective parties.
- As a result of the finding by the Court of Appeal it should not be assumed that the mere fact of

being the investment manager of a fund would bestow authority to negotiate and enter into side letter agreements with investors on behalf of a fund. Specific and express authorisation is necessary and cannot be assumed from general delegation of investment powers to the manager.

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## Meet the Author



[Rachael Reynolds KC](#)

Global Senior Partner

[Cayman Islands](#)

E: [rachael.reynolds@ogier.com](mailto:rachael.reynolds@ogier.com)

T: [+1 345 815 1865](tel:+13458151865)

## Key Contacts



Oliver Payne 彭奥礼

Partner 合伙人

Hong Kong

E: [oliver.payne@ogier.com](mailto:oliver.payne@ogier.com)

T: +852 3656 6044



Marc Kish

Partner

Cayman Islands

E: [marc.kish@ogier.com](mailto:marc.kish@ogier.com)

T: +1 345 815 1790

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